

INTERNAL REVENUE SERVICE

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Dear [REDACTED]:

Commissioner Rossotti asked me to respond to your inquiry dated December 14, 2001, on behalf of [REDACTED]. You asked about the Internal Revenue Service rules and regulations affecting the per diem rates paid to [REDACTED].

An employer's payments to employees generally are included in the employee's gross income and are treated as wages subject to employment taxes [Section 61 of the Internal Revenue Code (the Code)]. However, if an employer reimburses deductible business expenses and meets the other requirements of an accountable plan, the reimbursement is not wages and is not included in income or subject to employment taxes [See § 1.62-2 of the Income Tax Regulations].

An employee may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business [Section 162(a)(2) of the Code]. However, personal, living, or family expenses are not deductible [Section 262 of the Code].

Whether an employee is "away from home," requires a determination of the employee's "tax home" [Rev. Rul. 93-86, 1993-2 C.B. 71]. If a taxpayer has more than one place of business, the principal place of business is generally considered the employee's tax home. The principal place of business is determined by where the taxpayer spends more of his time, engages in greater business activity, and derives a greater portion of his income. [*Markey v. Commissioner*, 490 F.2d 1249 (6th Cir. 1974)].

For purposes of computing business expense deductions for away-from-home expenses under section 162(a), a state legislator may elect to treat his residence within the legislative district he represents as his tax home, unless it is 50 or fewer miles from the state capitol [Section 162(h) of the Code]. If the election is made, the legislator's allowable travel expenses are deemed to be the greater of: (1) the number of legislative days, multiplied by the per diem rate generally allowed to employees of the legislator's State, to the extent the State's per diem rate is no greater than 110 percent of the

federal per diem rate, or (2) the number of legislative days multiplied by the federal per diem rate [Section 162(h)]. Generally, legislative days are the days the legislature was in session or the legislator's presence was formally recorded at a committee meeting, but do not include the days of any recess period of more than four consecutive days. [Rev. Rul. 82-33, 1982-1 C.B. 28].

The federal per diem rate is: the sum of the federal lodging expense rate plus the federal meal and incidental expense (M&IE) rate for the day and locality of travel. The rates for localities within the continental United States are set by the General Services Administration. You can find the rates in:

- The Federal Travel Regulations, Appendix A of 41 C.F.R. § 301
- Publication 1542, *Per Diem Rates* (enclosed)
- The government website at <http://www.policyworks.gov/perdiem>

If a legislator does not, or is not entitled to make the election, any travel expense reimbursement is subject to the general rules for determining the legislator's tax home, substantiation, [Section 274(d) of the Code] and accountable plans [Section 62 of the Code].

As noted above, in order to exclude the reimbursements for deductible travel expenses from gross income the reimbursement arrangement must be an accountable plan [Section 1.62-2(c)(4)]. An accountable plan generally requires the employee to substantiate the amount of the expense and the business purpose for the expense to the employer and to return amounts exceeding expenses [Section 1.62-2(c)(1)].

The Commissioner of Internal Revenue may prescribe rules under which an arrangement providing per diem allowances will be treated as an accountable plan, even though the arrangement does not require the employee to substantiate actual expenses, or to return amounts exceeding expenses. The allowance must be reasonably calculated not to exceed the employee's anticipated expenses. The employee must substantiate that he or she was traveling on a particular day and must return any allowance for days of travel not substantiated [Section 1.62-2(f)(2)].

Under this authority, the Commissioner annually publishes a revenue procedure (currently Rev. Proc. 2001-47, 2001-42 I.R.B. 332, enclosed). This procedure provides that per diem allowances set at or below the federal per diem rates will satisfy the substantiation requirements for amounts of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses incurred while traveling away from home under section 274, and therefore, will satisfy the requirement of returning amounts exceeding expenses [Section 1.62-2(f)(2)]. An employer may choose to pay a travel allowance greater than the federal per diem rate, but the excess

is generally treated as wages, which would be subject to employment taxes and included in the employee's gross income.

I hope this information is helpful. Please call me at (202) 622-4800 or Sean M. Dwyer, , at (202) 622-5020, if you have any questions.

Sincerely yours,

KIMBERLY L. KOCH
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Enclosures (2)